

POWERS TO GROW: CITY FINANCE AND GOVERNANCE

SEPTEMBER 2014



ABOUT THE CITY GROWTH COMMISSION

Chaired by renowned economist Jim O'Neill, the City Growth Commission seeks to understand:

- how we can achieve complementary growth between London and our other cities
- what fiscal powers and governance arrangements are needed to deliver this, and
- how public service reform can start to make cities more fiscally sustainable

The ultimate objective of the Commission's twelve month inquiry is to lay the foundations for a stronger UK economy through a significant power shift away from the centre and towards cities, and to show the next government, of whichever party, why this is needed and how it can be achieved. Our recommendations will set out a road map for change; the Commission

will seek to influence all political parties in the run up to the 2015 UK General Election, and make the case for cities to take a new role in our political economy.

The Secretariat is hosted and run by the RSA, an organisation committed to finding innovative and practical solutions to today's social challenges through its ideas, research and 27,000-strong Fellowship.

The City Growth Commission was launched in October 2013 and is funded by the Mayor of London, London Councils, the Core Cities Group and the Local Government Association. Our partners include New Economy Manchester, the British Venture Capital Association, Universities UK and the Joseph Rowntree Foundation.

FOREWORD

BY JIM O'NEILL

In each of our three previous City Growth Commission report I found myself arguing each was the most important – well at least to date! There we set out to define what we mean by metros and the scope of our analysis; skills and employment; and connectivity and infrastructure.

In this report, we discuss in detail the crucial topic of city finance and governance – significant issues for our policymakers at all levels of government to consider in order to realise the full potential of the UK economy.

Here, and in our final recommendations in October, we present the ideas of the Commissioners and the RSA research team. But, what is ultimately critical for our metros to thrive is for each to identify what is right for them. Just as it is the case that those in Whitehall are hardly in a position to know what is best for the future of different parts of our country, however well-intentioned, it is also the case that our central recommendations, again well-intentioned and evidenced-based, may work for some cities and not for others.

As we highlight, the degree of centralised control in the UK is dramatic compared to other major economies, whether developed or developing, and it doesn't seem obvious as to why this makes good economic sense for either those that live in different parts of the country nor the country as a whole. As we have all witnessed with the run-up to the Scottish referendum on independence, some of our citizens want to have more decisions made about their futures by those who live and operate in their communities. However, the economic importance of our metros is the basis of our medium

and long-term economic future. What happens in the likes of Bristol, Cardiff, Edinburgh, Glasgow, Leeds and all of the other 15 metros we defined in our first paper will be more important for UK economic growth than what happens in the rest of Scotland combined.

So enabling the leaders of these major urban areas to decide what is right for them, and with it, for them to carry the responsibility for those decisions is crucial. In this report, we lay out the key areas of financial responsibility we believe should be transferred to *some* metros. Crucially, and as clearly suggested by the Chancellor in early August, it is only sensible to devolve this fiscal responsibility to those urban areas that can demonstrate they can succeed with this greater autonomy. We have found from our evidence gathering around the country that some metros are more ready today than others, and it would not make sense to devolve responsibility to them all now. Indeed, it is probably the case that only the best organised and most focused should be given those responsibilities.

We have deliberately held back from naming those metros that might be capable of increased responsibility in this report. The experience of our previous reports has taught us that our ideas can quickly gain traction, promoting responses from national and city leaders; our recommendations for limited devolution for some today might encourage others to organise themselves more effectively to warrant the same responsibilities tomorrow.

CONTENTS

FOREWORD	2
ABOUT THIS REPORT	4
EXECUTIVE SUMMARY	6
1. THE RISE OF THE CITY STATE	12
2. THE ROADMAP TO DEVOLUTION	24
3. RECOMMENDATIONS	27
REFERENCES	34

ABOUT THIS REPORT

This report, the Commission's fourth research output, is based on evidence received and research undertaken by the City Growth Commission. It has been informed by three regional hearings and in-depth discussions with experts across local, city and national governments, academia, other think tanks and consultancies, as well as written evidence submitted to the Commission.¹

In this report, as with all reports of the City Growth Commission,² we use the concept of a metropolitan area as the relevant geography to understand city growth. Metros are not just about city centres. Their reach extends to suburbs and surrounding areas as places of work, leisure and retail. Many rural businesses, for example, depend upon metros for accessing urban markets, customers and the connectivity cities provide to the rest of the UK and the world. This report uses the terms metro, city and city-region interchangeably.

Acknowledgements

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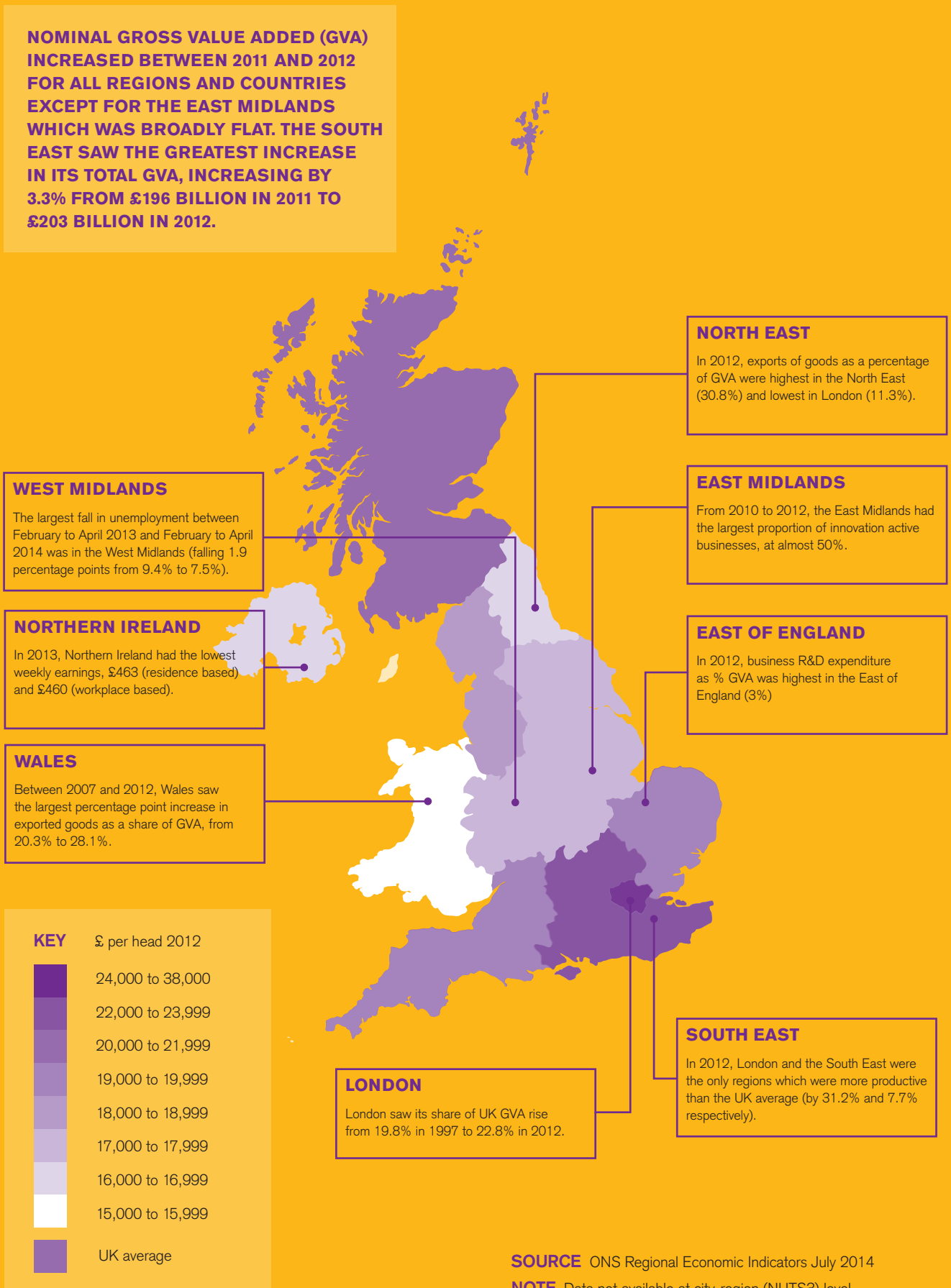
The practitioners and policymakers with whom we have consulted in this project are too extensive to mention here. However, particular thanks should be extended to a few individuals who have been particularly generous with their time and support: Damien Smith, Joe Manning and Andrew Sissons (Cabinet Office, Cities and Local Growth Unit), Jeremy Skinner and James Lee (Greater London Authority), Karl La Ferla (Infrastructure UK, HM Treasury), Tom Flude (Transport for London), London Councils Finance and Performance Team, and colleagues at the Local Government Association. Thanks also go to those who responded to the City Growth Infrastructure Survey. These responses were especially helpful for framing the debate.

1. Available to view online at www.citygrowthcommission.com.

2. See our first three research outputs, "Metro Growth: The UK's economic opportunity", "Human Capitals: Driving UK metro growth through workforce investment" and "Connected Cities: The link to growth".

ECONOMIC SNAPSHOT

NOMINAL GROSS VALUE ADDED (GVA) INCREASED BETWEEN 2011 AND 2012 FOR ALL REGIONS AND COUNTRIES EXCEPT FOR THE EAST MIDLANDS WHICH WAS BROADLY FLAT. THE SOUTH EAST SAW THE GREATEST INCREASE IN ITS TOTAL GVA, INCREASING BY 3.3% FROM £196 BILLION IN 2011 TO £203 BILLION IN 2012.



SOURCE ONS Regional Economic Indicators July 2014

NOTE Data not available at city-region (NUTS3) level

EXECUTIVE SUMMARY

Innovative, competitive and resilient economies are built on stable institutions that engender trust between trading partners, encourage investment in quality infrastructure and public services, and foster socially productive communities.

In the UK, one of our strongest attributes as a major global economy is the strength of our institutions: our trusted legal system forms the backbone of many international contracts, our mature and transparent legislative system helps to minimise political risk for investors over the long term, our independent Bank of England depoliticises our monetary policy and balanced regulation provides a stable platform for competition in global markets.

However, the configuration of our political economy – while cultivating this healthy business environment – is holding our metros back. The UK economy is falling short of its potential as our cities, with their concentration of labour, capital and information flows, are stifled by the overt centralisation of policy decision-making.

While global competitors are free to invest in their major cities, UK metros are at the mercy of central government, hoping for a cut of a fixed pot of national income. The UK has the most centralised system of public finance of any major OECD country; sub-national taxation accounts for only 1.7 percent of Gross Domestic Product (GDP), compared to 5 percent in France and 16 percent in Sweden.³

With this comes tight ringfencing of capital and resource funding, most of which

is awarded on an annual basis. Revenues are inflexible, uncertain and contingent on national politics. The economics of ‘place’ are not part of the complex Local Government Finance equation, leaving cities restricted in the degree to which they can respond to the current and future needs of their functional economic areas.

Over recent months, the importance of cities in driving growth and prosperity has been increasingly recognised, rising up the political agenda to the highest levels. Two speeches from the Chancellor of the Exchequer, a commitment from the Leader of the Opposition that he would ‘champion devolution’ in government and an active listening campaign from the Deputy Prime Minister – *Northern Futures* – have set a new political tone.

Already many of the Commission’s ideas have gained traction in Whitehall and Westminster, notably the Chancellor’s warm welcome of improved East-West connectivity via the proposed ‘One North’ integrated transport system.⁴ A clear space for real change has opened up in policy terms; metros could soon be in the drivers of economic policy-making.

However, this report argues that while much has been achieved under the Coalition to further the cause of city-led growth (e.g. City Deals, Growth Deals and the formal establishment of 5 Combined Authorities) the UK’s default mode of centralisation which emerged over the last half century, still represents a significant hurdle. This

3. Travers, Professor, T. for the Local Government Association (2012).

4. One North (2014). A strategic transport proposition put forward by city regions Leeds, Liverpool, Manchester, Newcastle and Sheffield.

report addresses some of the biggest challenges involved in the decentralisation process, with a view to embedding transformational reform.

To compete on the global stage, the City Growth Commission argues that UK metros need sufficient decision-making powers and flexibilities to become financially self-sustainable. Social and democratic arguments for devolution have been made by others,⁵ and while the City Growth Commission recognises many of these, we concentrate on the merits of the economic case for change. Working with local partners to support growth and deliver high quality public service outcomes, metros need to be empowered to tackle the long-term causes of welfare dependence, manage down their share of the national deficit and – by more integrated, informed investment decisions – help put the UK economy on a more inclusive, sustainable footing.

This report stands behind the conclusions of the London Finance Commission and Communities and Local Government (CLG) Select Committee report, but aims to go further, advocating more ambitious decentralisation and devolution for those cities able to shoulder the burden of genuine risk.

Devolution should not be a top-down blanket ‘policy’ but a process through which the UK’s major metros can benefit from new powers and flexibilities that match their capability and ambition. For some cities, the economics of agglomeration – concentrating and connecting highly productive resources – might remain elusive. Local politics and entrenched identity issues can make collaboration within and between functioning economic areas difficult; modern travel to work patterns do not always align with the legacy of administrative boundaries or the relationships between local authorities. Similarly, changing demographics can pose both opportunities

and challenges to the social and economic fabric of our cities, with some facing the prospect of a fall in the suitably-skilled working-age population.

City-regional devolution will take time, as national and local governments develop a more mature partnership, respecting new boundaries and spheres of influence. Crucially, it will rely upon demonstration of sophisticated financial capability and risk management, enabling metros to deliver their share of continued budget consolidations.⁶

City-regional devolution will also hinge upon effective governance and accountability structures, visionary leadership and the economic growth potential to ride the difficult storms of decentralisation and devolution. City-region devolution is therefore not for everyone.

Our recommendations do not immediately apply to all metro areas as some are not yet ready to deal with those challenges or responsibilities. But some cities do already exhibit these qualities and are eager to take the opportunity to power their economic futures with greater autonomy. For these cities, central government must relinquish control as soon as is practical.

If the UK economy is to continue to grow, and if this growth is to be inclusive and sustainable, our cities need to be empowered to reach their economic potential. This will require devolution of finance away from central government to city-regions, as well as genuine decentralisation of decision-making and risk transfer.

This Commission supports decentralisation to the top 15 metros in the country,⁷ as defined in our first research output,⁸ as economic growth measures denote that these metros are most fit for supporting decentralisation. This does not, however, preclude decentralisation to other metros

5. See for example Communities and Local Government Committee (2014) and Institute of Public Policy and Research (2014).

6. In the context of unprecedented levels of public sector debt and cross-party commitment to deficit reduction, this is a valid concern that the City Growth Commission recognises needs to be addressed.

7. London, Greater Manchester, West Midlands, West Yorkshire, Glasgow, Merseyside, Tyne and Wear, South Yorkshire, East Midlands, South Hampshire, Edinburgh, Cardiff Capital, Bristol, Belfast, Leicester, South Sussex, South Dorset, Teeside and Potteries metros.

8. City Growth Commission (2014).

or localities at a later stage, should they be ready to operate under a reformed system.

Those 15 metros will wish to move at different speeds along the devolution and decentralisation trajectory. For example, Greater London already holds certain powers that allow for some strategic finance and planning across the capital region, but the city has ambitions to grow and respond more flexibly to the changing needs of its rapidly growing population. Meeting these challenges will require greater devolution of decision-making and financial controls, including devolution to groups of boroughs, if deemed appropriate. To achieve this, the London Finance Commission has prioritised devolution of property taxes as a key next step.

Meanwhile, other cities have indicated a desire to retain business rates, set council

tax bands, apply a ‘tourist tax’ or pool their finance streams to enable place-based budgeting at city-regional scale without departmental ringfencing. The City Growth Commission argues that the spectrum of economic potential, administrative capability and local political ambition can be accommodated, but it will demand a radical shift in how national and city-regional governments see themselves.

With that in mind, we advocate a series of recommendations for cities and central government, found on page 27. Some should be applied across the board, suggesting asks of both central government and metros, while others will need to be implemented in consideration of individual metros’ readiness for further decentralisation and devolution.

DEFINITIONS

The Commission uses the following definitions for decentralisation and devolution to metros:

Decentralisation: denotes the relaxation of central government’s control over spending programmes, allowing local retention of revenue and freedom to spend central government grant funding (both capital and revenue) without ringfencing, creating a move away from siloed, project-based spending, allowing local areas to flexibly spend according to local needs and characteristics.

Fiscal devolution: denotes the passing of a set of powers down from central to metro governments’ control, enabling metros to:

- Raise and retain funding through a range of existing taxes and charges, such as property taxes;
- Pool revenue streams and leverage other assets, giving metros the

- flexibility to borrow, for example, through the creation of place-based budgets;
- Have sufficient flexibility to create a sustainable borrowing portfolio within the rules of the Prudential Code,⁹ which includes borrowing in open capital markets. For example, cities may choose to follow a similar arrangement as agreed via the Silk Commission in Wales, granting borrowing flexibility up to a maximum of £400 million, enabling a limited, known sum to appear on the central balance sheet.

Devolved Status: status given to metros that have been independently assessed as demonstrating robust governance and accountability structures, visionary leadership and the economic growth potential sufficient to ride the difficult storms of devolution. Devolved Status implies metros receive all aspects of fiscal devolution defined above.

9. Chartered Institute of Public Finance and Accountancy

KEY TAKEAWAYS FOR METRO GROWTH

The strength of UK institutions is one of our strongest attributes as a major global economy. Yet, despite cities being the drivers of UK growth, the configuration of our political economy is holding our metros back. Metros are at the mercy of central government, with tight restrictions on capital and resource funding – limiting the degree to which metro leaders can respond to the current and future economic, social and environmental needs of their city.

While many of the City Growth Commission's proposals have already gained traction across political spheres, the default mode of 'Whitehall knows best' still remains a significant hurdle to future economic prosperity. Radical change to overcome this can be achieved, but only if all three parties are daring enough to take on the groundbreaking package of fiscal devolution measures put forward in this report.

Some cities are ready and able to take on the responsibility and associated risks of devolution – they have the leadership, financial management and accountability structures to administer a devolved city-region – and should be freed to drive investment, job creation, inclusive sustainable growth and public service reform as soon as is practical. Greater representation in national decision-making forums from these metros and associated collaboration with other metros will also serve to ensure – for the first time – our urban powerhouses can enhance the UK's economic potential.

The City Growth Commission does not advocate that all metros should take this leap. Devolution is a process and not a top-down blanket policy so should be treated as such – other metros will need to wait until their economic performance, potential and governance structures lend themselves to devolution. In the

meantime, we advocate reforms across the board, for both central government and metros, including:

- Tax and local government finance reform;
- Constitutional and Whitehall reform; and
- Demonstration of metro commitment to competence and capability

And further decentralisation for those ready to gain greater autonomy and move along the trajectory towards devolution, including:

- Multi-year finance settlements;
- Freedom to spend grants without ringfencing and greater borrowing flexibilities; and
- The ability to retain the proceeds of growth through outcomes-focused finance models.

Of course central government will still continue to have a role; the Commission does not advocate full devolution. Central government will still be dominant in setting and administering taxes where there is a clear argument for national rates (e.g. income tax, corporation tax or VAT). Similarly local government finance will still be allocated from central coffers for places without the administrative capacity or economic basis for financial self-sustainability.

Metros have proven their economic worth. Now is the time for the central government to follow suit and allow those that are ready to take forward greater metro autonomy for the good of their cities and the UK economy as a whole.

CITIES DRIVE GROWTH BUT ARE HELD BACK

CITIES ALREADY ACCOUNT
FOR UP TO 80 PERCENT
OF GLOBAL GDP



75%

OF THE WORLD'S
POPULATION WILL
LIVE IN CITIES
BY 2050



31%

IN TOTAL, CHINA'S 600
CITIES ARE EXPECTED
TO HOST 31 PERCENT
OF ALL GLOBAL GDP
GROWTH TO 2025

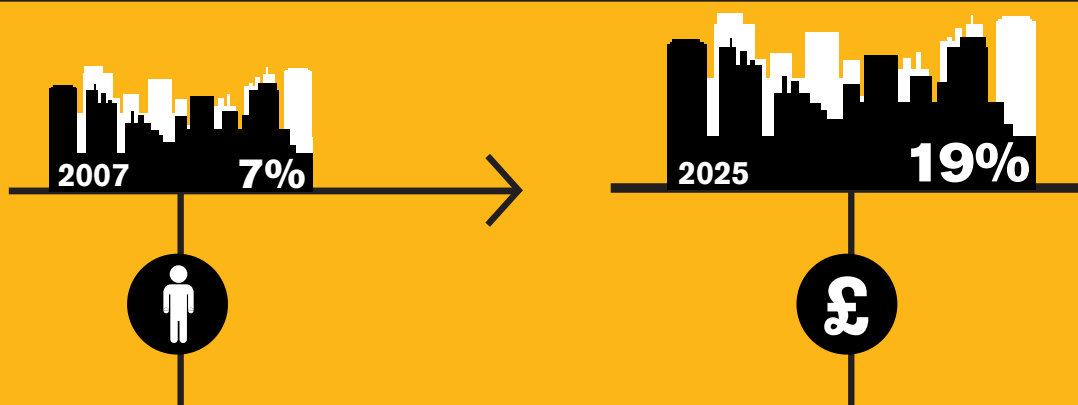
CITIES DRIVE GROWTH BUT ARE HELD BACK



61%

OF UK GROWTH
IS GENERATED
BY CITY REGIONS¹⁰

IN THE LAST 10 YEARS, CORE CITIES¹¹
GREW BY **9.6** PERCENT AGAINST OVERALL UK
POPULATION GROWTH OF **7.6** PERCENT, WHILE
WIDER LOCAL ECONOMIC PARTNERSHIP AREAS,
ANCHORED BY CORE CITIES, GREW BY **6.1** PERCENT.¹²



CITIES WITH POPULATIONS
BETWEEN 200,000 AND
2 MILLION HAD 7%
OF GLOBAL POPULATION
IN 2007

BUT ARE FORECAST TO
GENERATE 19% OF ALL
GLOBAL GDP GROWTH
THROUGH 2025¹³

10. Centre for Cities (2014). Note: city-regions here refers to the Centre for Cities definition of Primary Urban Areas

11. The Core Cities are a self-defining group of the largest 8 cities in England by population size: Birmingham, Bristol, Glasgow, Leeds, Liverpool, Manchester, Newcastle, Nottingham and Sheffield.

12. Figures calculated by Oxford Economics for Core Cities (2013), estimated 2003–2013.

13. McKinsey Global Institute (2011).

1. THE RISE OF THE CITY STATE

“Already global business is beginning to plan strategy from a city, rather than a country, perspective. Understandably so: well over half of the world’s population lives in cities, generating more than 80 percent of global GDP. Standard population projections show that virtually all global growth over the next 30 years will be in urban areas.”
The Economist Intelligence Unit (2013)¹⁴

We live in an urban age. Cities and their suburbs are increasingly powerful in national and global politics and are driving economic growth in developed and emerging markets across the world. This trend is set to continue, already accounting for up to 80 percent of global Gross Domestic Product (GDP).¹⁵ The importance of metros as centres of knowledge with intensive and highly productive activity makes the political economy of cities hard to ignore. Empowering our cities gives them the opportunity and scope to fulfil their economic potential, creating thriving places of inclusive, sustainable growth and prosperity.

The academic literature has increasingly emphasised the role of the metropolitan area – or city-region – as the appropriate unit of analysis for tackling social, political and economic problems. In ‘If Mayors Ruled the World’ Benjamin Barber argues that the globalised economy has grown ‘too big’ for our nation states to respond effectively. Multinational companies, global supply

chains and international flows of labour and financial capital are creating a world where national boundaries are subsumed by global economics.

“Today, after a long history of regional success, the nation-state is failing us on the global scale. It was the perfect political recipe for the liberty and independence of autonomous peoples and nations. It is utterly unsuited to interdependence.”

... the city now appears to be our destiny. It is where creativity is unleashed, community solidified and citizenship realized. If we are to be rescued, the city rather than the nation-state must be the agent of change.”
Benjamin Barber (2013)¹⁶

While impact might be detected at the macro level, the challenges and uncertainties of a globalised economy are experienced at a local level. Here, national governments are too removed, constrained by ‘incomplete information’ and ‘coordination failure’ (in the jargon), which prevents them from acting in an optimal, integrated fashion.

As more people live in cities, and these centres of economic activity account for more of nations’ wealth, the politics of metros are gaining importance. The City Growth Commission has considered what this means for the UK political economy: what is the role of cities in enabling a more locally responsive,

14. The Economist Intelligence Unit (2013).

15. The Economist Intelligence Unit (2013).

16. Barber, B. (2013).

innovative and productive place? What economic levers and political structures are needed to realise this? How can the UK break our default mode of centralisation and benefit the economy as a whole?

City-led devolution has risen up the UK political agenda rapidly in recent months. In June 2014, the *Wales Bill*¹⁷ went into the House of Lords and will enter the committee stage in October, shortly after the result of the Scottish referendum on independence on the 18th of September. The latter, in particular, has prompted discussion about the ‘English question’ and, whilst largely ignoring that constitutional can of worms, senior figures in each of the main political parties in Westminster have committed to champion city-led devolution in some guise.

“Devolving power from Whitehall to our towns and cities is essential to generate the new jobs we need. Cities and towns that come together with local businesses will be given historic new powers over transport, housing, skills and economic development... And towns and cities will be given clear incentives too: by being able to share in the proceeds of growth in their area.”

*Leader of the Opposition, Ed Miliband (April 2014)*¹⁸

“... local leaders and businesses need a much bigger say in where public investment in their areas should be targeted in the future... Nobody knows more about what local economies need than the people who actually live and work day in and day out in the communities themselves.”

*Deputy Prime Minister, Nick Clegg (July 2014)*¹⁹

The democratic arguments in favour of decentralisation and devolution (see, for example, Institute for Public Policy Research (IPPR) (2014))²⁰ are strong and timely in our age of chronically low voter

turnout. Political engagement and devolution are tightly related, creating a virtuous circle of taxation powers, accountability and political engagement at the local level. With the most recent electoral turnout at around only 36 percent, local democracy is in desperate need of revival, and genuine devolution would give significant impetus.

The City Growth Commission recognises the importance of accountability and the relationship between a thriving local democracy and its effective use of public finance in pursuit of inclusive and sustainable economic growth. Already, 61 percent of UK GDP is generated by city-regions,²¹ this proportion will increase significantly as city populations continue to rise disproportionately²² and knowledge-intensive industries cluster in and around city-centres. For economic reasons, we therefore argue that **our political institutions of policymaking, regulation and financial management should be reconfigured away from central government towards metros.**

This economic argument has gained traction domestically over recent months. The Chancellor of the Exchequer dedicated two speeches to realising the potential of the ‘Northern Powerhouse’ by improving connectivity between northern cities to magnify agglomeration effects, heighten productivity and create more jobs. Citing OECD analysis, he accepted:

“... there is a powerful correlation between the size of a city and the productivity of its inhabitants. The top 600 cities in the world contain just 20 percent of global population but create 60 percent of global GDP. Over recent decades economists have explored all the different reasons why cities raise their residents’ productivity: specialisation is greater, competition and economies of scale increase, ideas

17. Wales Office (2014).

18. Miliband, E. (2014).

19. Clegg, N. (2014).

20. Institute of Public Policy Research (2014).

21. Centre for Cities (2014).

22. The Economist Intelligence Unit (2013).

and innovation spread faster. Crucially, cities are also where clusters of successful industry are created – like the financial services cluster in London, or the digital economy of California’s Silicon Valley.”
Chancellor of the Exchequer, George Osborne (June 2014)²³

The Communities and Local Government (CLG) Select Committee has also put forward its case for devolution in England, with the link to economic growth a central pillar of the argument:

“...fiscal devolution – as part of a package of wider decentralisation – would encourage greater economic growth across England. The Government has, through its own business rates retention scheme, accepted the logic behind this. Putting a wider range of tax and borrowing powers into the hands of local politicians simply extends this logic... Cities and their wider regions have the most potential to drive growth.”
CLG Select Committee Report (July 2014)²⁴

This report was soon followed by a draft *Independence for Local Government Bill*,²⁵ proposed by Graham Allen, a respected backbench MP. The London Mayor, London Councils and Core Cities also published a statement of progress against the London Finance Commission’s detailed report of 2013.²⁶ The concepts of fiscal decentralisation and city-led devolution are increasingly being considered as vital if we are to put the UK economy on more productive, sustainable footing.

“The more control local governments have over the revenue they raise, the easier it is for the public to hold them accountable for delivering results, which helps make governments more innovative and effective. Across the world, city

leaders are tackling the biggest challenges we face – from fighting poverty to addressing climate change – with bold new ideas. But doing so requires money. Empowering cities to invest in their own futures not only makes them stronger, it makes their nations stronger, too.”
Michael Bloomberg, Mayor of New York City (2002–13)²⁷

Crucially, **metros are the right scale for convening the powers and expertise required to appropriately drive social, environmental and economic change** within an area. They create opportunities for difficult political decisions to be made in support of growth – decisions that single local authorities might otherwise not be able to take (e.g. building on Green Belt land). As shown by the recent ‘One North’ proposal on transport connectivity between five northern cities,²⁸ they also provide the scale needed to work with other cities in the UK to lead and shape strategic infrastructure investment.

Together, these political advantages mean city-regions have sufficient critical mass to compete on the world stage against other leading metro economies. But to achieve this potential, metros need greater freedoms and flexibilities – individually and collectively – to make strategic decisions in the long-term interest of their populations and the wider economic sustainability of the UK as a whole.

Making the shift from centralisation to city-led growth

History has firmly shaped the nature and extent of centralisation in UK governance. The legacy of Beveridge’s universal welfare state has embedded public expectations of centrally determined and, more recently, centrally guaranteed minimum service standards. This has gradually eroded power and accountability away from local areas and created a vicious cycle of ever diminishing capability. Without sufficient influence over how local finance is spent

23. Osborne, G. (2014).

24. Communities and Local Government Committee (2014).

25. Private Members’ Bill (2014).

26. Greater London Authority (2014).

27. Quoted in Greater London Authority (2014).

28. One North (2014).

and with ever declining grant funding, local government's incentive to invest in capability is eroded. Central government then has little incentive to devolve power and financial responsibility to those local areas.

Many of the messages of decentralisation and devolution are not new. Talk of the need to move away from the UK's highly centralised system has been around for decades. What appears to be new is the degree to which central government is starting to take heed of this talk and put it into action. For example, the *Localism Act* of 2011²⁹ brought some further flexibility to the Greater London Authority (GLA) enabling it to determine how to spend housing and transport funding, and allowed for the creation of City Deals – tailored arrangements between individual city-regions and central government – aimed at providing targeted grants and greater flexibility

Yet these actions were only a tentative step in the right direction. The same *Localism Act* introduced greater restrictions on council tax, the only tax fully retained by local authorities. The City Deals, and their successor 'Growth Deals', were a deeply centralised process in which cities' 'homework was marked' by Whitehall officials and city-led strategies for growth were reduced to funding specific projects. Far from Lord Heseltine's 'single pot',³⁰ the Local Growth Fund deals were reduced to a competitive funding bid model, with relatively small local projects given the green light by central government. Too often, cities feel like there are two steps forward and one back, promised policy initiatives get turned into Whitehall processes that have a tendency to revert to a centralising default mode.

Despite this, the move by the Coalition Government to support the models of Earn Back, Gain Share and greater flexibility for other specific projects, e.g. *West Yorkshire plus Transport Fund*, is welcome. Anything that moves the UK slightly further away from

its highly centralist system of governance is a step in the right direction. The UK is the most centrally-controlled system of public finance of any major OECD country, with sub-national government taxation accounting for only 1.7 percent of GDP, compared to 5 percent in France and, at the top of the scale, 16 percent for Sweden.³¹

That limited control over taxation means that, compared to their counterparts in other developed nations, UK cities disproportionately rely on central government funding. The centre dictates how, what and when central government funding and revenue should be spent and generated, without due regard to local need and economic conditions. Such dependence on central government arguably puts UK city-regions at a disadvantage in relation to our international competitors. Instead, metros rely on an outdated system that restricts innovation and integrated investment, constraining the ability of local leaders to support the specific requirements of businesses and individuals within their wider city-regions.

There has been a long-term trend of UK people wanting Scandinavian-style high-quality public services but with low American-style taxes.³² Yet without significant public service reform (including greater data-driven, outcomes-focused policy-making), expectations on the quantity and quality of public services will have to be restrained. The ever-declining pot of public funds and ever-rising need for services to support the UK's ageing population mean that a large gap is opening up, most noticeably at the local level, where much of the effects are felt – the gap between expenditure and funding is expected to widen to £12.4bn by 2019/20.³³

Reform is needed to enable city-regions to manage their budgets more strategically between services and over time. This will allow greater investment in economic development and preventative spend,

29. Department for Communities and Local Government (2011).

30. Heseltine, Lord M. (2013).

31. Travers, Professor, T. For LGA (2012) Giving evidence to the CLG Select Committee Professor Travers added "even if the 50% of business rates that local authorities have retained since April 2013 were included, the figure would only rise to perhaps 2.5 percent" CLG Select Committee (2014).

32. Ipsos MORI (2012).

33. Local Government Association (2014).

helping to manage down the demand for welfare. The most ambitious metros are eager to play their part in driving local and national economic growth, and becoming financially self-sustainable. For example, new HM Treasury analysis shows that if the northern cities of the UK were able to grow at the same rate projected for the whole of the UK, it would add £56bn in nominal terms to the northern economy, benefiting these cities and UK growth as a whole.³⁴

Realising this projection of economic uplift will require central government and city-regions to find a new understanding, where both share the risks and responsibilities of reducing the deficit, managing down public sector net debt and making decisions in the best interests of metros and the UK economy as a whole. While Detroit, for example, is often used as a case against decentralisation, much can be learned from this city's decline (see 'Detroit – a case against decentralisation'). An ambitious package of fiscal devolution

DETROIT – A CASE AGAINST DECENTRALISATION?

Throughout the first half of the 20th century, Detroit had emerged as a major national automotive manufacturing centre, growing to a population of 1.85 million by 1950, the 5th largest city in the U.S.. By 2008, the city's population had more than halved in size and in July 2013 the city filed for bankruptcy. At an estimated \$18–20bn debt, it represented the largest municipal bankruptcy filing in U.S. history.

Ineffective and unaccountable local leadership was a significant factor in Detroit's decline. Compounded by global economic shifts in manufacturing towards Asian producers as well as deep social problems of racial segregation, the city experienced a stark 'hollowing out' of its inner city. This further eroded the tax base and exacerbated levels of poverty. Today, one third of Detroit's citizens live in poverty; median family income is about half the U.S. average and in 2008, the city had one of the highest murder rates in America.

Reliant on its single industry, and heavily influenced by the wishes of major employers General Motors and Ford, local investment decisions were made to the detriment of wider public transport, amenities, infrastructure and skills, undermining the city's growth over the long run.

"Detroit's twentieth-century growth brought hundreds of thousands of less-well-educated workers to vast factories, which became fortresses apart from the city and the world. While industrial diversity, entrepreneurship, and education lead to innovation, the Detroit model led to urban decline. The age of the industrial city is over, at least in the West."

Edward Glaeser, 'Triumph of the city' (2013)³⁵

WHAT LESSONS CAN WE LEARN FROM THIS?

- Despite a directly elected mayor and the appointment of an 'emergency fiscal manager' in 2013, Detroit failed to rectify its economic and financial woes. Whatever the structure of governance and leadership, accountability mechanisms need to be transparent and robust;
- Large cities often have the advantage of a diverse, resilient sectoral base. This enables dual-skilled households to move into the area, with a reasonable promise of gainful employment in different sectors, creating a virtuous circle of investment, job creation and high productivity. Without economic diversity, growth is unlikely to be sustainable in the face of external shocks.

34. Osborne, G. (2014).

35. Glaeser, E. (2013).

measures of the type described in this report can be ground-breaking and doesn't need to end in problems for HM Treasury; if they are daring enough, all three major parties have the ability to effect radical change.

Embracing the 'postcode lottery'

An innate challenge for city-led growth and decentralisation is the 'postcode lottery' critique. Coined only in the 1990s, the term captures a deeper expectation among the British public that the role of the (central) State is to ensure equality of opportunity and access to public services and welfare.

City Growth Commissioner, Tony Travers, argues that this expectation emerged in the 1930s because with the "*advent of Keynesian economics, the Beveridge report and the economic depression...*" there was a "*shift in the balance of control away from local government and towards the centre.*"³⁶ Subsequent policy shifts in response to, and anticipation of, irresponsible local authority tax-and-spend tactics have entrenched a political culture in which local and regional disparity is resolved by redistributing and ringfencing locally-raised revenues. The UK's political economy has created a default mode of centralisation as a safeguard for equality.

As a result, a common argument levied against decentralisation and city devolution is that it will exacerbate inequality between places and constrain the ability of central government to redistribute accordingly. Indeed, this *might* be the case and more than one witness at the Commission's formal evidence hearings made this point.³⁷

However, the centralised efforts to redistribute resources and minimise variation in local outcomes had been ineffective. For example, Professor Alan Harding of the Heseltine Institute at the University of Liverpool Management School noted "*many places that were poor 30 years ago are still poor now*" as cities policy – to the extent it exists beyond the collection of other decisions impacting at the metro level – "*hasn't made a lot of difference*". What, he asked, explains

why those policies do not work better than they could or should?³⁸

The answer lies in the fact that city-regions are not uniform in their economic activity, social productivity or needs. Centrally determined policy, lacking local information and coordination, relies on the mere hope that one size fits all. Metro-led devolution and decision-making would enable integrated investment and pooled place-based budgeting for the benefit of the city centre and its surrounding economic area. With the right fiscal and financial flexibilities, metros could be sufficient in scale, ambition and reach to raise and redistribute revenue within their own areas.

This is already starting to happen in some areas that are setting up business-rate pools, spreading the gains from places within the city-region that have a higher tax base and growth potential to those where the strain on public resources is greater. Over time, however, effective economic development should allow an increase in the proportion of revenue to be reinvested in productive forms of capital, enabling the welcome rise – some argue – of "postcode choice".³⁹

It is not the case that devolution removes the need for redistribution entirely. The City Growth Commission makes clear that central government will still be dominant in setting and administering taxes where there is a clear argument for national rates to avoid undue complexity or perverse 'cross-border' behaviours (e.g. income tax, corporation tax or VAT). Similarly, local government finance will still need to be allocated from central coffers for places that do not have the administrative capacity or economic basis for financial (let alone fiscal) self-sufficiency.

However, those metros that have the leadership, financial management and accountability structures to administer a devolved city-region, should be freed to drive investment, job creation and inclusive, sustainable growth. Collaboration between metros and with greater metro representation in national decision-making forums, will also serve to ensure – for the first time – our urban powerhouses can enhance the UK's growth potential.

36. Travers, T., and Esposito, L., (2003).

37. City Growth Commission Public Evidence Hearings (2014).

38. City Growth Commission Manchester Evidence Hearing (2014).

39. City Growth Commission Manchester Evidence Hearing (2014).

SURVEY RESULTS

100% OF RESPONDENTS⁴⁰ FELT A MODEL SIMILAR TO **EARN BACK OR GAIN SHARE** WOULD APPEAL, BUT SAW THE FOLLOWING AS BARRIERS TO PROGRESSING SUCH DEALS:

CENTRAL GOVERNMENT



71%

LACK OF FINANCE TO SUPPORT THE SCHEME



47%

OTHER COMPETING PRIORITIES



29%

40. Respondents here refers to the 18 responses to the City Growth Commission Infrastructure Survey conducted June 2014. We had 17 responses from Core and Key Cities across the country and a collective response from London Councils, taking the total to 18 responses. All quotes from cities that appear throughout this report are taken from survey responses.

SURVEY RESULTS

POPULAR POLICY OPTIONS



DEVOLUTION OF FINANCIAL INSTRUMENTS TO CITY LEVEL

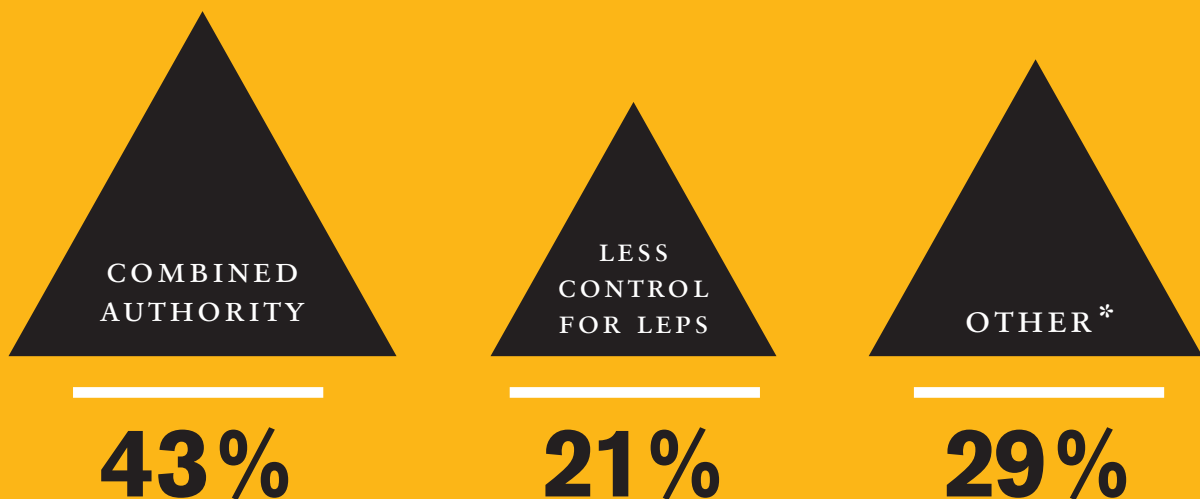


DEVOLUTION OF ACCOUNTABILITY TO CITY LEVEL



IMPROVING CAPABILITY/CAPACITY OF THE CITY

POPULAR GOVERNANCE STRUCTURES



* WHICH INCLUDED UNITARY AUTHORITIES AT CITY-REGION LEVEL, DEVOLVED SETTLEMENT BACKED BY STATUTE, FLEXIBILITY IN REGULATIONS TO ALLOW GOVERNANCE STRUCTURES TO BE LOCALLY DESIGNED

THE UK PUBLIC WANTS SCANDINAVIAN PUBLIC SERVICES BUT AMERICAN TAXES

People have different views about the ideal society. For each of these statements, please tell me which one comes closest to your ideal.	JAN 2006	APR 2009	JUN 2012
	%	%	%
a) A society which emphasises the social and collective provision of welfare	48	47	41
b) A society where individuals are encouraged to look after themselves	46	49	42
c) No opinion	6	4	17
Total	100	100	100

Base: 1,011 British adults 18+ Source: Ipsos MORI (2012)⁴¹

CENTRALISATION OF UK TAX AND SPENDING

Tax set at each level of government as a % of GDP	LOCAL GOVT	STATE/ REGIONAL GOVT	LOCAL + STATE/ REGIONAL	CENTRAL GOVT	SOCIAL SECURITY	TOTAL
Canada	2.9	12.3	15.2	12.9	2.9	30.7
France	6.0	0.0	6.0	14.9	24.3	45.3
Germany	3.1	8.1	11.2	11.8	14.4	37.6
Italy	7.4	0.0	7.4	23.4	13.5	44.4
Spain	3.2	10.6	13.8	7.4	11.6	32.9
Sweden	16.2	0.0	16.2	22.3	5.7	44.3
United Kingdom	1.7	0.0	0.0	26.6	6.8	35.2
United States	3.7	4.9	8.6	10.3	5.4	24.3
OECD (2011)	3.9	5.2	9.1	20.3	8.4	34.1

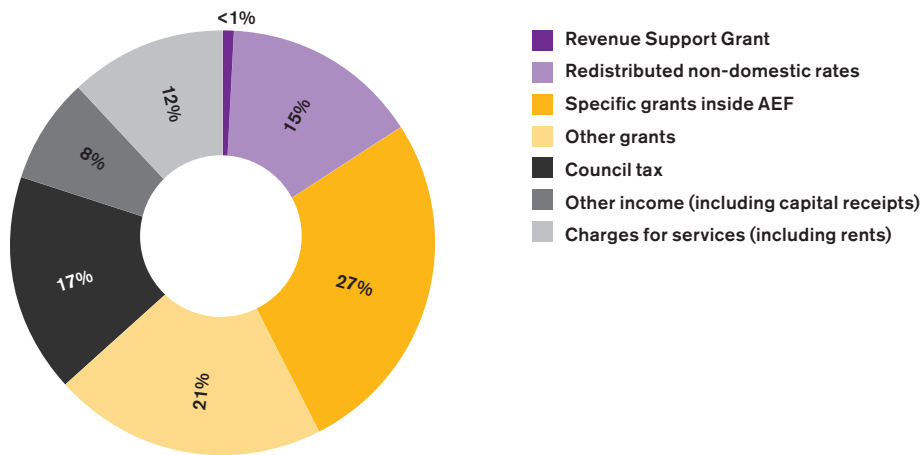
All figures related to 2012, except the OECD totals which are for 2011. Source: Travers, Prof. T. for the LGA (2012),⁴² data from the OECD.⁴³

41. Ipsos MORI interviewed a representative sample of 1,011 adults aged 18+ across Great Britain. Interviews were conducted by telephone 9th to 11th June 2012. Data are weighted to match the profile of the population. Where percentages do not sum to 100 this may be due to computer rounding, the exclusion of "don't know" categories, or multiple answers. Responses for 2006 and 2009 from Ipsos MORI for 2020 Public Services (2011).

42. Travers, Professor, T. for the Local Government Association (2012). Giving evidence to the CLG Select Committee, Professor Travers added "even if the 50% of business rates that local authorities have retained since April 2013 were included, the figure would only rise to perhaps 2.5 percent" Communities and Local Government Select Committee (2014).

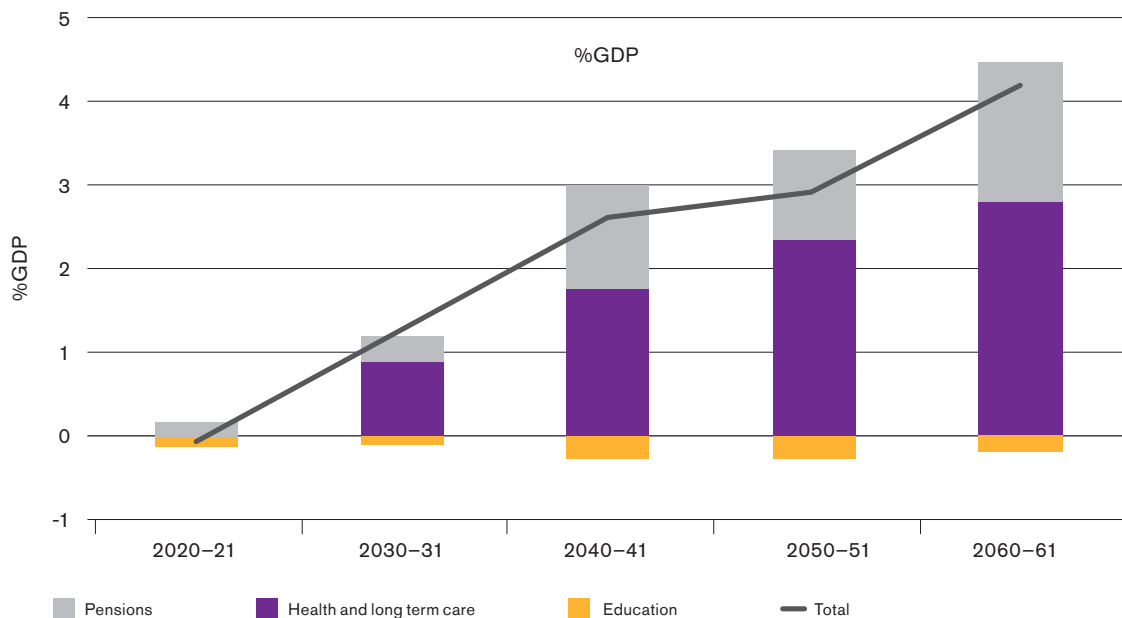
43. OECD (Downloaded August 2014).

63% OF TOTAL LOCAL GOVERNMENT INCOME RECEIVED IN 2012–13 WAS IN THE FORM OF CENTRAL GOVERNMENT GRANTS, WITH COUNCIL TAX RECEIPTS MAKING UP 17% OF TOTAL INCOME⁴⁴



Source: Department for Communities and Local Government (2014)

RISING PRESSURE OF AN AGEING POPULATION



Source: HM Treasury (2014)⁴⁵

44. Department for Communities and Local Government (2014). Note AEF stands for Aggregate External Finance

45. HM Treasury (2014).

TIMELINE OF CENTRALISATION



VARIATION CREATES INCENTIVE FOR CENTRALISATION

- 1925 *Rating and Valuation Act* brought different local authority rates into one single rate.
- Local authorities still responsible for recalculations
- Burden of local tax increasingly falls onto domestic ratepayer.

EQUALISATION DRIVES LOCAL GOVERNMENT FINANCE REFORM

- 1948 *Local Government Act* gave unringfenced central grant to local authorities on the basis of need. Aim of equalisation through redistribution.
- Local authorities increasingly reliant on grants as rates revenue diminishes as rates revaluation repeatedly stalled.
- 1958 *Local Government Act* aimed to increase local independence by enlarging local tax base and emphasising general rather than specific grants.

INDUSTRIALISATION BRINGS PROSPERITY AND INEQUALITY

- As early as 1870, *Goschen Report* expressed mounting concern as to fragmentation of local welfare institutions.
- Rationalisation of local structures via 1888 *Local Government Act*. Provision not regulated until mid 1930s.

BEVERIDGE REPORT (1942) FOR UNIVERSAL STANDARDS

- Central state as the guarantor of universal access to services of the highest quality based on need
- Services mostly funded by general taxation;
- Delivered primarily by the state
 - by 1950 electricity, gas, local hospitals, major trunk road all under central control.

1970–80s

1980–90s

1990–2000s

2000–2010s

2010 ONWARDs

CENTRAL-LOCAL RELATIONS AT LOWEST EBB

- Centre controls profligate local authorities by effectively capping rates (1984).
- Poll tax introduced in Scotland (1989) and England and Wales (1990). Backfires on central government, although local authorities set flat rate.
- Council Tax introduced 1993 based on 1991 valuation – never updated.

DEVOLUTION AND REGIONAL DEVELOPMENT

- New Labour creates Devolved Administrations in Scotland and Wales (1998), granting limited fiscal, spending and other policy powers.
- 8 Regional Development Agencies in England (1998) awarded (total) £1.8–2.3bn single pot funding per year.
- Greater London given devolved powers under *2000 Local Government Act*, which also gave all local authorities responsibility for economic, social and environmental well-being.

CITY DEALS FOR SOME, GROWTH DEALS FOR ALL

- Coalition abolishes RDAs in 2010, creating Local Enterprise Partnerships (LEPs) with increasing responsibility.
- Trigger referendum in *Localism Act 2011* for Council Tax increases above 2%.
- 28 City Deals for largest/fastest growing cities followed by Growth Deals and Single Local Growth Fund allocation in July 2014.

NEW PUBLIC MANAGEMENT (NPM) DRIVES SERVICE REFORM

- Launched under Major and accelerated by Blair, NPM seeks to embed increased information, choice, clear standards, user consultation, and greater accessibility to more responsive services.
- New Localism undermined by concerns of 'postcode lottery' and government response of targets and national minimum standards.
- Academies and Foundation Trust hospitals designed to improve local freedom and accountability

CENTRAL CONTROL OF SERVICES TIGHTENS UNDER RISE OF MONETARISM

- By end of mid '70s water supply, sewerage, local health services under central control.
- Internal markets first introduced, with contestability and Compulsory Competitive Tendering and privatization (e.g. British Telecom in 1984 and British Gas in 1986).

PROMISES OF DEVOLVED POWER FALL SHORT

- Central deficit budget cuts hit local government hardest, with fall of 1/3 over the course of Parliament. Leaves non-statutory services (e.g. housing, planning) particularly exposed.
- Policy and regulation increasingly centralised (e.g. school curriculum, hospital inspection).
- New Homes Bonus, Community Infrastructure Levy and Business Rate Retention designed to enable and reward growth, but often in lieu of other funds.

2. THE ROADMAP TO DEVOLUTION

The RSA City Growth Commission supports the conclusions of the London Finance Commission and CLG Select Committee reports,⁴⁶ similarly arguing for greater autonomy, decentralisation and devolution. However, the Commission has aimed to go further, advocating more ambitious devolution for city-regions able to shoulder the burden of fiscal and financial risk. These metros, which would be few in number to start with, would be granted **'Devolved Status'**.

Achieving Devolved Status will depend upon metros demonstrating robust governance and accountability structures, visionary leadership and the economic growth potential to ride the difficult storms of decentralisation and devolution. We believe the focus on the metro scale is vital here to realise the economic benefits of such bold reform.

In order for decentralisation and devolution to be meaningful and sustainable, both national and city-level governments would need to adapt to new boundaries and spheres of influence. This joint effort would enable a move from dependence to collaboration, for greater growth for the UK as a whole.

City-regional devolution needs to be a *process* through which the UK's major metros can benefit from new powers and flexibilities that match their ambition and capability. It means central government will have to make a conscious shift to realise its own rhetoric. The Local Growth Deals announced in

July 2014, for example, were initially intended to enable single-pot financing of strategic economic priorities agreed by LEPs and local authorities. By the time they had been through the Whitehall machine, they amounted to little more than central government approval of specific local projects that happened to align with ministerial priorities. Such veiled 'centralised localism' needs to stop.

As a first step, we advocate the creation of an independent City-Region Devolution Committee. This Committee would take decision-making outside of the immediate political- and Whitehall arena and allow for an open, transparent and independent assessment of metros' readiness for devolution.

Securing greater autonomy

To be granted Devolved Status metros will need to demonstrate they are able to take on the risks associated with devolution. The diagram below illustrates a framework by which metros could be assessed on their suitability for devolution. It demonstrates that a combination of capabilities and economic strength is needed to ensure cities have the administrative capacity to mitigate and manage downside risk, as well as maximise economic opportunities. As metros are able to generate and increasingly rely upon their own revenues, so too must they be able to cope with volatility of revenue from devolved taxes over the business cycle.

46. London Finance Commission (2013) and Communities and Local Government Committee (2014).

INDEPENDENT CITY-REGION DEVOLUTION COMMITTEE

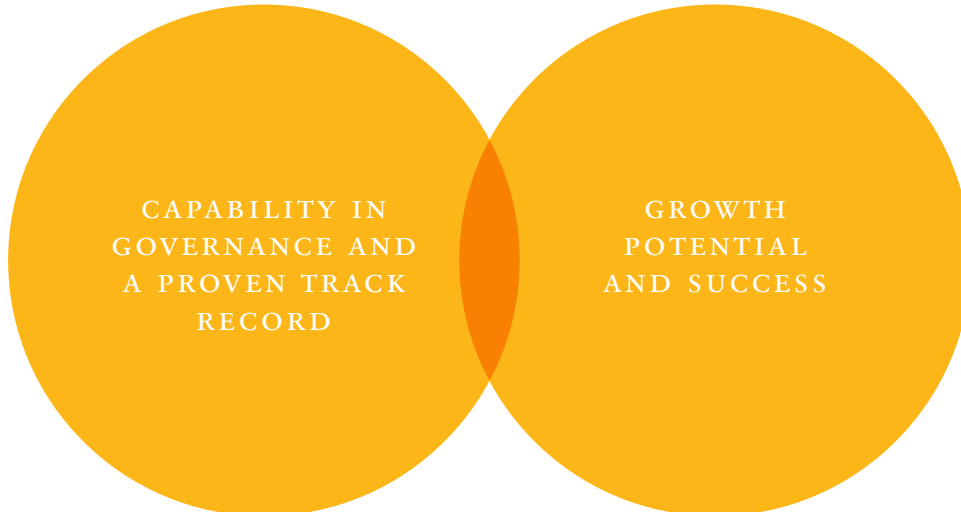
An independent City-Region Devolution Committee would evaluate metro applications for Devolved Status. A standard set of criteria would be devised by the Committee regarding capability, governance and economic potential, against which bids will be assessed in an open and transparent manner.

The independent Committee would make recommendations as to whether

individual metros should proceed to negotiating the specifics of their Devolved Status with central government.

To ensure continued effectiveness of governance and a continued drive for growth, metros' Devolved Status should be reviewed at least every five years, enabling Combined Authorities to propose and bid for new powers, and for new metros to achieve Devolved Status when they are able.

DEVOLVED STATUS VENN DIAGRAM



Capability in Governance and a proven track record

A robust, accountable model of governance is needed for effective collaboration between local authorities to ensure decisions can be taken in the best interest of the city-region. The Combined Authority model demonstrates great potential in delivering this strong and stable structure, enabling places to cooperate along boundaries they identify with and align relevant LEP boundaries accordingly.

However, there might be other resilient forms of governance that metros choose to adopt, with varying degrees of formality and flexibility. For example, London could see the development of groups of boroughs with the creation of sub-city regional Combined Authorities, setting and delivering strategic priorities within their boundaries while working within London-wide devolution and the overarching mayoral structure of the GLA, to deliver a strong strategic vision for growth across the capital.

To support this process, metro governments may also consider the applicability of introducing an elected or non-elected mayor or chief executive into their model of strong, stable governance. The Chancellor has publically advocated elected mayors, with HM Treasury seeing them as an indicator of good governance. While many benefits can abound from the introduction of a mayor (e.g. visible leadership domestically and abroad), this is unlikely to be applicable to all metros and metros should be free to decide if, when and how the metro should be led, with the aid of a public referendum if a metro so chooses.

Growth potential and economic success

In order to weather the volatility and downside risks that come with devolution, metros will need to demonstrate their economic success as well as their future growth potential. Growth promotion in a city means putting strategic plans in place to support, promote and encourage the creation of innovative and successful clusters across sectors, connecting people with high quality transport infrastructure, enabling information flows and attracting talent from across the country and globally.

Together with a long-term commitment to education, skills development and public health delivery, each tailored to meet the current and future needs of the city's population, creating future growth potential requires the promotion of sustainable, inclusive growth. The Commission heard from several cities about their concern regarding economic and social inequality – a problem that puts additional strain on public services and welfare, already under pressure from increased demand and diminishing resources.

As a result, economic growth means more than simply increasing Gross Value Added (GVA) and boosting headline Gross Domestic Product (GDP). To avoid spiralling costs, whether from welfare and public services or adaptation to climate change (e.g. flood defences), the distribution of the proceeds of growth across the city-region will need to enable increased social productivity and promote environmental sustainability over the long-term.

**“GOVERNANCE WILL NOT MAKE A DIFFERENCE
BY ITSELF – IT ALSO REQUIRES POWER
(E.G. OTHERS TO BE ACCOUNTABLE TO IT)
AND RESOURCES”**

–LIVERPOOL

3. RECOMMENDATIONS

The City Growth Commission makes a bold economic case for the UK’s major metros to be given the opportunity to receive, at a minimum, greater flexibility about how they pool and spend revenue streams, and, for the most mature metro political economies, devolved fiscal powers. These powers will enable city-regions to make more effective, integrated decisions for their functional economic areas, allowing for redistribution within city-regions and investment for a more prosperous future.

For any metro granted Devolved Status, central government must relinquish control as soon as is practical. Other cities not granted this status should be assisted to take on greater autonomy over the longer term, while they continue to operate under the current system until such time as they are ready and wish to apply for further decentralisation and devolution.

With that in mind, we advocate a series of recommendations for cities and central government. Some should be applied across the board, while others will need to be implemented in consideration of individual metros’ suitability for fiscal devolution:

- 1. Reform across the board: asks of central government**
- 2. Reform across the board: asks of metros**
- 3. Policy and financial decentralisation for leading metros**
- 4. Devolution to ‘Devolved Status’ metros**

1. Reform across the board: asks of central government

1.1 Tax reform

The *Mirrlees Review*⁴⁷ was the most comprehensive analysis of the UK tax system in decades. This review called for a modernisation and streamlining of the system to create a progressive and economically efficient UK tax environment. We propose the *Mirrlees Review* be revisited – in light of moves towards greater decentralisation and devolution – to consider how taxes and the tax base might more closely reflect the modern UK economy.

Those taxes most likely to be devolved (e.g. property taxes for Devolved Status metros) would undergo a *dual process of evaluation* rather than a long, drawn-out national review under the tax reform rubric, to be followed, only then, by consideration for devolution. We would not wish to see tax reform used as an excuse for delaying devolution to cities.

1.2 Constitutional reform

Fiscal devolution and decentralisation are ultimately about constitutional change in the distribution of power and accountability within the UK. The UK’s ‘unwritten constitution’ has allowed for flexibility and adaptability, but it has been a one-way street towards greater centralisation since the 1948 *Local Government Act*, with notable

47. Mirrlees Review (2011).

exceptions of devolved powers to Scotland, Wales and London.

The *Greater London Authority (GLA) Act 1999* granted significant transfer of powers to the GLA and started London on the route to greater autonomy, arguably opening the door to the great economic growth it experiences today. While we recognise that the details of constitutional reform are beyond the remit of this Commission, we believe that cities (including London) need a new legal settlement to strengthen and widen the *GLA Act of 1999* to metros granted Devolved Status by the independent City-Region Devolution Committee.

A binding legal entity provides a platform for metros to coordinate and collaborate within their boundaries to create stable, formally recognised governance structures (be that a Combined Authority or otherwise). It should also enable Devolved Status metros to levy taxes at a city-region scale and make appropriate arrangements for sharing those revenues across the metro region.

Metro leaders – whether directly or indirectly elected – would then be accountable directly to Parliament, against place-based priorities, perhaps supported by a City-Regional Public Accounts Committee of local MPs.

1.3 Removing the requirement for referenda on council tax

The *Localism Act 2011* introduced a requirement that all local authorities wishing to raise council tax over 2 percent in one year would be required to hold a referendum. Central government has also incentivised local areas to freeze council tax and apply for other funding through central government, putting extra downwards pressure on council tax and constraining local financial autonomy all the more.

We recommend the requirement for referenda be removed for all local

authorities, restoring freedom over this form of local revenue and putting council tax back on an equal footing with all other UK taxes, which do not require specific mandates for each individual rate rise.

1.4 Local government finance reform

The Independent Commission on Local Government Finance, chaired by Darra Singh, has been set up by Chartered Institute of Public Finance and Accountancy (CIPFA) and the Local Government Association (LGA) to examine:

- The current position of the local government finance system;
- A potential new system that enables better public services and encourages economic growth;
- Practical options for changing the system that could be implemented by an incoming government.

The City Growth Commission encourages this programme of work to develop and test options for local government finance reform – an issue increasingly pressing in the face of rising demand for health and social care, education and skills development, as well as housing. Interim findings of the Local Government Finance Commission will be published in autumn and the final report is due in early 2015.⁴⁸

1.5 Reform of central government

In order to support decentralisation, reform of Whitehall and the civil service is needed to minimise the risk of falling back to the default mode of ‘Whitehall knows best’. Attempted reforms under the Coalition government have sought to improve the commercial skillset of the civil service and introduce more ‘open policy-making’ involving industry partners and other external stakeholders.

However, a more fundamental reform is needed to drive change. For example, the creation of a single public service

48. Independent Commission on Local Government Finance (2014).

rather than separate central and local level bureaucracy could be a step towards aligning the status of local government officers with that of Whitehall officials.

1.6 Private finance market

The City Growth Commission's *Connected Cities* report⁴⁹ describes how the UK currently lags behind our competitor economies in the quality and long-term sustainability of our infrastructure. Often, central government policy uncertainty is to blame for limited domestic and international investment. Enabling metros to have greater flexibility over their long term planning and financing of capital projects – including the ability to pool domestic and EU revenue streams – could pave the way to greater long-term strategic investment in infrastructure for growth.

In addition, we recommend government take steps to attract greater private finance for metro infrastructure. A similar model has previously been advocated by the Smith Institute in their call for the creation of a British Investment Bank to support funding in housing and local growth.⁵⁰ We suggest that various options for infrastructure finance are considered by Infrastructure UK, complete with metro-leader representation (as argued in *Connected Cities*).

Metros with Devolved Status and an independent credit rating should also be free to raise finance – within the Prudential Code – from private markets.

2. Reform across the board: asks of metros

2.1 Demonstrate commitment to competence and capability

In return for granting greater flexibility, cities that wish to move along the trajectory of greater decentralisation and devolution should build up their capability and expertise, demonstrating a stable system of effective, accountable governance. This could include:

- a. **Private and public sector swaps** to build and share expertise, particularly around financial management;
- b. **In addition, metros should actively recruit from different sectors**, attracting good talent with appropriate salaries;
- c. **Data and information:** Metros should actively work to improve their collection and analysis of data and other evidence. This would enable them to evaluate the impacts of metro investment and provide supporting evidence on bids to the independent City-Region Devolution Committee. Building on their existing engagement with businesses, Local Enterprise Partnerships (LEPs) should develop capacity to provide a formal data-driven advisory role;
- d. **Metros should demonstrate collaboration** between and within metros. Where possible, this should also include collaboration with public service agencies (e.g. health- and social care) to align strategy, policy and delivery across the metro region.

“MORE LOCAL CONTROL
(E.G. TAXES RAISED AND RETAINED
LOCALLY, PLACE-BASED APPROACH,
LONGER BUDGET CYCLES) ENABLES
LONGER-TERM CERTAINTY AND PLANNING”

– NEWCASTLE

49. City Growth Commission (2014).

50. Falk, Dr. N for the Smith Institute (2014).

“GOVERNMENT SHOULD PROVIDE FLEXIBILITIES
AND REGULATIONS TO ALLOW LOCALLY
DESIGNED SOLUTIONS”

– PLYMOUTH

3. Greater decentralisation for leading metros

We recommend Devolved Status metros and those deemed on the path to devolution (by the Independent Commission) be enabled to pool and allocate retained revenue and central government capital and revenue grant without ringfencing. In support of this we recommend:

3.1 Multi-year finance settlements

One-year finance settlements severely constrain the degree to which metros and public sector organisations can plan their expenditure and design strategic policy initiatives.

For example, Transport for London has estimated that stop-start funding can add between 10 and 15 percent to the costs of rail project investment with unplanned road works also costing six times more than planned ones, with emergency works some 30 times more. Long-term certainty would allow a constant programme of procurement and renewal to be put in place, generating long-term contracts with suppliers to achieve the best value for money and sustained jobs outside of London.⁵¹

The Commission recommends a five-year finance settlement be put in place for metros, with an extension to a minimum of 10 years for capital projects related to long-term strategic infrastructure investments. In-year budgeting would still apply.

3.2 Freedom to spend grants without ringfencing

The majority of local government finance comes from central government – 63 percent in 2013/14⁵² and, at face value, 20 percent of funding is ringfenced.⁵³ In reality, other unringfenced elements of grant funding are subject to centrally imposed restrictions and departmental policy.

We recommend that metros awarded greater decentralisation powers be given the flexibility to manage their grant funding without ringfencing. This would enable those metros to pool funding (capital and revenue) to finance growth-promoting activity in their metro region collaborating with other metros, the private- and third sector and delivery partners where appropriate. Metro-level flexibility would allow for greater efficiency of public spending by allowing cities to target funding in areas where there is most need, and focus on preventative investment to break cycles of welfare dependence.

3.3 More flexible borrowing arrangements

Whilst keeping in line with the Prudential Code and in-year budgeting, metros that have demonstrated their capability and been granted greater decentralisation should have the freedom to explore alternative borrowing options beyond the Public Works Loans Board.

For some metros (and similarly local areas) the cost of obtaining a credit rating might be too high and the incentive for

51. Investment in London's infrastructure is estimated to have supported 45,000 jobs outside of London in Transport for London's supply chain in 2013/14. GLA (2013).

52. Department for Community and Local Government (2014).

53. Centre for Cities (2014).

borrowing outside of the traditional system not strong enough. For those metros and local authorities, the LGA have devised a municipal bonds market⁵⁴ to allow them to access – individually or collectively – bond finance at a competitive rate. This could be a cost effective finance avenue for many metros.

3.4 Retaining the proceeds of growth

Leading metros should be free to explore new and emerging models of retaining a share of the upside of growth (and take on commensurate downside risk). Negotiated with central government under a positive presumption in favour of these forms of ‘payment by results’ models, such as

Tax Incremental Financing or Greater Manchester’s Earn Back.

- a. **Greater flexibility over the use of Tax Increment Financing (TIF)** where beneficial, to enable local authorities and cities to use a range of mechanisms to support infrastructure investment and economic development, based on reinvesting a proportion of an area’s future business rates.
- b. **Models similar to Earn Back and Gain Share:** While Earn Back-type models have become increasingly popular with three other propositions now in train, HM Treasury seems to have reached the limit of its appetite to negotiate such deals while still proving the concept. However, some metros that currently have an Earn

EARN BACK

This Greater Manchester inspired reform, agreed as part of the City Deal in 2012, was the first of its kind in the UK. It aimed to mirror the way in which a city would approach growth investment under tax localisation, without any actual change in tax structure. It links a locally funded step change in infrastructure investment to a ‘payment by results’ revenue formula agreed with HM Treasury. This revenue formula provided Greater Manchester with a share of the tax proceeds HM Treasury would gain as a result of growth generated by locally funded investment. After protracted and difficult negotiations, an initial formula was agreed in 2013. Recognising the innovative nature of the Earn Back mechanism a review process was included in the agreement to allow for further development and improvements over time.

Three similar propositions are in play across Glasgow, Leeds (West Yorkshire plus York) and Greater Cambridge. Combined, the metros covered by these propositions are home to just under 7 million people, with combined economies of more than £130bn in annual Gross Value Added (GVA).

The government’s position on this, and future models, is not wholly clear, with proposals for these models finally agreed, but arguably from the cities’ point of view, much diminished from their initial proposals. Part of the issue lies with a lack of a mechanism or metrics in the Office of Budget Responsibility (OBR) that would allow HM Treasury to take account of the additional revenues it would receive if it were paying out under an Earn Back-type formula. The implicit assumption is that any additional growth in one place simply substitutes for the same amount of growth elsewhere; there are no overall productivity gains and no increases in labour market participation, and therefore no net national increase in GDP or net additional tax revenues. This leaves only costs on the scorecard which, according to current accounting rules, can appear more than once – up-front capital spend by the city, addition to national debt due to city borrowing, and the payments to city over time. The government is ill-equipped to engage with cities on the current and forecast linkages between investment and growth.

Back model may wish to move forward to apply for Devolved Status, and other metros may then come to the fore, demonstrating economic potential and competence in governance to take on and negotiate Earn Back-type models without full devolution. Although not suitable for all, the City Growth Commission nevertheless recommends that Earn Back and Gain Share models be available for metros when negotiating the extent of their decentralisation reform package.

4. Devolution for Devolved Status metros

For those metros independently assessed as meeting the economic and governance conditions for ‘Devolved Status’, a change of mindset within the city-region and Whitehall will be needed to support a new relationship between the two tiers of government. Devolved Status would be predicated upon a productive, collaborative relationship where metros have the autonomy and accountability to manage their city-regions as they see fit to support long-term growth and prosperity.

This significant shift from the centre to the metro would allow – as above – metros to pool revenue streams and leverage assets, as well as borrow more freely in open capital markets. Crucially, it would also enable Devolved Status metros to:

- **Raise and retain funding through new and existing taxes;**
- **Integrate public service reform and economic development with a new power to convene other public and quasi-public-sector bodies** (e.g. Network Rail, local Further Education Colleges, NHS England, Public Health England); and,
- Take their seat at the table in national policy making – extending the principle for infrastructure outlined in *Connected Cities* of **special attendance or a permanent place at Cabinet and sub-Committee meetings**. Metro representation would enable more informed, strategic national decision-making.

Over the long-term, many metros with Devolved Status may wish to aim for financial self-sustainability. However, it is important to note that the City Growth Commission does not anticipate that metros can or should become entirely fiscally self-sustainable. There will remain some taxes and tariffs including, for example, National Insurance contributions and corporation tax, best levied and redistributed at the national level.

4.1 Devolution of taxes

Metros granted Devolved Status will see a significant shift – from the centre to metros – in determining the mix and rate of taxes, enabling metros to choose from a range of taxes, including property – and sales tax. Under devolution, metros would be revenue-neutral against a baseline and revalued at each Spending Review (or annually, in the case of property taxes).

Cities ready to shoulder the burden may aspire to the **full suite of property taxes** (e.g. stamp duty land tax, council tax, business rates, annual tax on enveloped dwellings, capital gains on property). Several of these taxes may require central and/or local reform to ensure they more closely reflect cities’ tax base and the modern UK economy. For example, in accordance with the London Finance Commission, Greater London is ready to receive – under a revenue-neutral settlement – all five property taxes, taking the share of the capital’s total tax base from 6 percent to 11.5 percent.⁵⁵ Other cities, given the dynamics of their own property markets, might not prioritise this form of devolved taxation.

All Devolved Status cities should be free to:

- a. **Retain business rates:** in line with the London Finance Commission, we recommend business rates be fully devolved to metros with Devolved Status, alongside a corresponding reduction in the central government core grant. This will allow cities with Devolved Status to set, revalue and reform business rates as they see fit.

55. Greater London Authority estimates (2014)

Metros would therefore be free to move away from the uniform business rate.

The recently reformed scheme of business rate retention, tariff and top-up allows local areas to retain 50 percent of their business rate revenue, which is then supplemented or tarified depending on a central government assessment of the area's funding requirement and the revenue collected. Full devolution of business rates to metros with Devolved Status would require reform to this current system. For example, if London were granted full devolution, the Exchequer would lose an estimated £800 million in 'excessive growth' tariffs each year. A corresponding reduction in central government core grant to those areas with Devolved Status would be required to supplement this loss of revenue.

Any reform or rate change would also require engagement with the business community. The Crossrail supplement demonstrates that businesses are willing to accept an increased rate rise, and contribute towards investment, if they can see the genuine benefit to them as a business. We recommend that the LEPs in each metro leverage their role as business engagers to work with Business Improvement Districts (BIDs) and other business organisations to aggregate the business voice, testing proposals before they are put into practice;

- b. **Revalue and set council tax bands:** cities with Devolved Status should be able to flex and reform council tax, including revaluing and upgrading bands as they

see fit (in accordance with Valuation Office regulations);

- c. **Other taxes or subsidies:** metros should have greater flexibility to create and fully retain new specific taxes that reflect the needs of the city economy and are mindful of the local impacts on markets and behaviour. By negotiation with HM Treasury, these might include hotel taxes, environment/sustainability taxes and a local air passenger duty tax or subsidy.

4.2 Greater flexibility over the use of capital reserves

Throughout the Commission's inquiry we have heard from cities that the level and inflexibility of siloed funding streams is the key barrier to achieving their ambitions. One such inflexibility is over the use of capital reserves/receipts of sale of capital assets for revenue expenditure, a process known as 'capitalisation of revenue expenditure'.

Currently capital reserves/receipts cannot be used for revenue spending (although proceeds can be used to fund infrastructure investments) as HM Treasury believes allowing for this flexibility would fuel excess spending. We recommend the restrictions be lifted to allow Devolved Status metros to leverage their assets and pool these resources to support growth-promoting activity, within the bounds of the Prudential Code. This would put the UK in line with other OECD countries which have more flexible controls over the use of local authority capital reserves.

“HAVE AN ATTRACTIVE CITY DEAL THAT GIVES US DIRECT CONTROL OVER ALL BUSINESS RATE GROWTH IN OUR GROWTH LOCATIONS ACROSS THE CITY REGION. EARN BACK/GAIN SHARE WOULD BE ATTRACTIVE, HOWEVER, IT IS ANOTHER FORMULA GRANT AND WOULD HAVE SOME RELUCTANCE TO ENTER INTO SUCH A COMPLEX ARRANGEMENT AND WOULD RATHER JUST KEEP MORE OF THE TAXES RAISED IN THE CITY DIRECTLY”

– BRISTOL

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